DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS: 05-0505
Gross Retail Tax
For the Year 2002

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ISSUES

I. **Food Purchases** – Gross Retail Tax.

Authority: IC § 6-2.5-1-1 et seq.; IC § 6-2.5-3-2; IC § 6-2.5-5-20; *Hyatt Corp. v. Department of State Revenue*, 695 N.E.2d 1051 (Ind. Tax Ct. 1998); 45 IAC 2.2-5-38.

Taxpayer argues that the money it received for serving prepared meals was not subject to the gross retail tax.

II. **Abatement of the Ten-Percent Negligence Penalty**.

Authority: IC § 6-8.1-10-2.1; 45 IAC 15-11-2.

Taxpayer asks that the Department of Revenue exercise its discretion to abate the ten-percent negligence penalty on the ground that Taxpayer had no obligation to remit sales tax on the purchase of certain items.

STATEMENT OF FACTS

Taxpayer owns and operates a "guest area" and other facilities. These facilities serve two entities. The two adjacent entities are licensed to conduct separate, but coordinated businesses.

The entities' parent companies formed taxpayer as a joint venture in 1995. The two parent companies each have a fifty percent ownership interest in taxpayer. The intent of the two parent companies was to share the initial cost and ongoing expense of the land-based, support facilities – parking lots, food service, etc. – necessary for successful operation of the businesses.

The Department conducted an audit review of taxpayer's business records and tax returns for 2002. The Department concluded that taxpayer owed additional sales tax on the complimentary meals taxpayer served to the entities' employees and the entities customers, and additional use tax on various items. Accordingly, the Department issued notices of "Proposed Assessment." Taxpayer disagreed with the proposed assessment and submitted a protest to that effect.

Taxpayer paid the use tax portion of the "Proposed Assessment" during Indiana Tax Amnesty. However, Taxpayer did not pay the sales tax portion of the "Proposed Assessment." An administrative hearing was conducted during which taxpayer's representative explained taxpayer's position on the remaining, disputed issues. This Letter of Findings results.

DISCUSSION

I. **Food Purchases** – Gross Retail Tax.

Taxpayer is owned by two entities. Taxpayer supplies the ancillary, land-based services necessary for the operation of the entities. Each entity owns 50 percent of taxpayer.

Taxpayer operates a cafeteria which serves free meals to the entities' employees. In addition, Taxpayer serves free meals to the entities' customers. The customers are those who have received a complimentary meal voucher.

Taxpayer keeps records of the meals it serves to its own employees, the meals it serves to the entities' employees, and the meals it serves to the entities' customers.

Every month, Taxpayer sends a bill to each of the two entities for the cost of the meals served to the entities' employees and the entities' customers. The two entities reimburse Taxpayer for the cost of the meals served to these employees and customers.

The audit review found that Taxpayer should have collected sales tax on the reimbursements received from the entities. As stated in the explanation of adjustments, "An adjustment was made in the audit to assess [Taxpayer] for the sales tax that should have been charged on these food sales." However, the audit did not assess use tax on the food used to provide free meals to Taxpayer's *own* employees because, as stated in the explanation of adjustments, "Food provided by [Taxpayer] to its own employees would be a situation similar to that presented in the 'Hyatt' case."

Taxpayer argues that the meals served to the entities' employees and the entities' customers were exempt from sales tax under IC § 6-2.5-5-20(a) which states that, "Sales of food for human consumption are exempt from the state retail tax." According to Taxpayer, "In essence, [the entities] purchase food for human consumption exempt from Indiana sales tax under I.C. § 6-2.5-5-20 with the sole intention to provide that food free of charge to their employees and [customers]."

Taxpayer points to the decision set out in *Hyatt Corp. v. Department of State Revenue*, 695 N.E.2d 1051 (Ind. Tax Ct. 1998) as support for its position that the cost of the meals served to the entities' employees and customers was not subject to sales or use tax. In Hyatt, the petitioner-taxpayer argued that it was not subject to use tax on the food it purchased and served as complimentary meals to its own guests and employees. Id. at 1052. Petitioner-taxpayer claimed that, under IC § 6-2.5-5-20(a), its food purchases were exempt because the items purchased were "food for human consumption" and that the food items were not "food furnished, prepared, or served for consumption at a location, or on equipment provided by the retail merchant." Id. at

1054. *See* IC § 6-2.5-5-20(c)(8). The court agreed with petitioner-taxpayer's position. Petitioner-taxpayer was buying food for human consumption and giving away meals prepared with that food. Id. at 1056-57. The Tax Court found that, "the fact that the food [petitioner-taxpayer] purchased was not resold is irrelevant to the question of whether [petitioner-taxpayer's] food purchases qualify for an exemption under section 6-2.5-5-20." Id. at 1057.

Indiana imposes a sales tax on retail transactions and a complimentary use tax on tangible personal property that is stored, used, or consumed in the state. IC § 6-2.5-1-1 et seq. The use tax "is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction." IC § 6-2.5-3-2.

As noted above, "Sales of food for human consumption are exempt from the state gross retail tax." IC § 6-2.5-5-20(a). However, the phrase "food for human consumption" does not include "food furnished, prepared, or served for consumption at a location or on equipment provided by the retail merchant." IC § 6-2.5-5-20(c)(8). The Department's regulation restates the rule: "The gross retail tax exempts food for human consumption. Primarily the exemption is limited to sales by grocery stores, supermarkets, and similar type businesses of items which are commonly known as grocery food." 45 IAC 2.2-5-38.

Taxpayer is reimbursed for the cost of the meals served to the entities' employees and the entities' customers. The Department agreed that Taxpayer was not subject to use on the value of the food to Taxpayer's *own* employees. What is at issue is whether taxpayer should have charged the two entities sales tax for the cost of the meals served to the *entities'* employees and the *entities'* customers. Taxpayer argues that it was simply acting as an agent for the two entities. According to Taxpayer, it "is intended to operate at a loss, which loss is periodically reimbursed by [the entities]." Taxpayer concludes that, "[Taxpayer] is merely the vehicle through which that food is prepared and delivered. The purchase and the provision of such food to the employees and [customers] of [the entities] is not subject to Indiana sales tax."

Taxpayer indicates that it has acted as the entities' agent since its inception and that the arrangement was formally memorialized six years afterward. Taxpayer maintains that – because of the agency/principal relationship it has with the entities – it stands in the same shoes as the petitioner-taxpayer in *Hyatt*; because the entities could presumably have purchased food and served that food free-of-charge to the entities' own employees and the entities' own customers, taxpayer stands in the stead of the two entities and can purchase and serve meals to the entities' employees and guests without collecting sales tax.

However, it should be noted that Taxpayer wants something more than the petitioner-taxpayer in *Hyatt*. In that case, the petitioner-taxpayer wanted to buy unprepared food without paying sales tax. *Hyatt*, 695 N.E.2d at 1054-55. Taxpayer wants to receive tax-free payment from the entities for the cost of the cooked and prepared meals along with the cost of procuring, preparing, and delivering the food to the entities' employees and customers. As set out in the parties' Limited Agency Agreement, "In consideration of the [Taxpayer's] performance of its duties under this Agreement, [the entities] shall reimburse [Taxpayer] monthly for the actual cost of food purchased and other costs and expenses incurred in connection with the provision of food to [the

entities'] employees and [customers]." Essentially, Taxpayer wants to operate a restaurant/catering business without having to charge sales tax when it receives payment for serving meals.

The Department must respectfully disagree with Taxpayer's argument because it does not conclude that the rules governing the interplay between the gross income tax and agency/principal standards are relevant in determining whether a retail transaction occurs when the entities pay taxpayer for the cost of meals served to other than the Taxpayer's own employees. As recognized in the parties' own "Limited Agency Agreement," "[A]s part of [Taxpayer's] *Business*, [Taxpayer] maintains and operates [] a cafeteria for the purpose of producing, preparing and delivering food to [Taxpayer's] employees and to the [entities'] employees." (*Emphasis added*). Elsewhere in the same document, the parties recognize "also as a part of [Taxpayer's] *Business*, [Taxpayer] maintains and operates certain other facilities for the purpose of procuring, preparing and delivering food to the [the entities'customers] . . . . [Taxpayer] operates the [customer facilities] and provides such food free-of-charge to [customers] who bear compensation certificates . . . ." (*Emphasis added*).

The agency/principal arrangement is an irrelevancy in determining whether Taxpayer should have collected sales tax on the money it received for serving meals to other than its own employees. Taxpayer is in the "business" of running a restaurant/cafeteria service. It buys and prepares food which it serves to persons other than its own employees. Taxpayer receives payments based upon the number of meals served to persons other that its own employees. These transactions are subject to the gross retail tax, and Taxpayer should have collected sales tax each time it received a payment.

FINDING

Taxpayer's protest is respectfully denied.

II. Abatement of the Ten-Percent Negligence Penalty.

Taxpayer also protests that imposition of a negligence penalty on the assessment. IC § 6-8.1-10-2.1 requires that a ten-percent penalty be imposed if the tax deficiency results from the taxpayer's negligence. Departmental regulation 45 IAC 15-11-2(b) defines negligence as "the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer." Negligence is to "be determined on a case-by-case basis according to the facts and circumstances of each taxpayer." Id.

IC § 6-8.1-10-2.1(d) allows the Department to waive the penalty upon a showing that the failure to pay the deficiency was based on "reasonable cause and not due to willful neglect." Departmental regulation 45 IAC 15-11-2(c) requires that in order to establish "reasonable cause," the taxpayer must demonstrate that it "exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed . . . ."

Notwithstanding the Department's disagreement with Taxpayer's substantive arguments, Taxpayer has provided sufficient information to conclude that its failure to collect and remit sales tax was the result of a reasonable interpretation of Indiana's tax laws.

FINDING

Taxpayer's protest is sustained.

JR/BK/DK March 30, 2007